



Signed and Filed: February 28, 2011

Dennis Montali

DENNIS MONTALI
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re) Bankruptcy Case
THE LAWRENCE BUILDING COMPANY,) No. 10-33938DM
a California Corporation,) Chapter 11
Debtor.)
THE LAWRENCE BUILDING COMPANY,) Adversary Proceeding
Plaintiff,) No. 10-03189DM
v.) Adversary Proceeding
JON C. THUSH, SANDRA THUSH, et al.,) No. 10-03279DM
Defendants.)

MEMORANDUM DECISION REGARDING
DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

I. INTRODUCTION

Defendants' Motion For Summary Judgment ("Motion") came on before the court on February 4, 2011. Defendants Jon C. Thush ("Thush") and Sandra Thush appeared and were represented by David B. Draper, Esq. and Mark W. Good, Esq., two of their attorneys; Debtor and Plaintiff The Lawrence Building Company ("Debtor") appeared and was represented by Sheila Gropper Nelson, Esq., its attorney. For the reasons explained below, the court will grant the Motion, enter judgment for Defendants, and vacate the presently scheduled trial date of March 28-29, 2011.

1 II. BACKGROUND

2 Defendants owned a commercial building in San Jose,
3 California (the "Property") and on May 27, 2003, entered into a
4 Commercial Property Purchase Agreement ("Agreement") with Debtor
5 to sell it the Property. The Agreement apparently was drafted
6 primarily by Thush and contains somewhat unconventional terms that
7 are the core of the dispute between the parties here.

8 The Purchase Price for the Property, as described in the
9 Agreement, is \$1,645,000. Of that amount, Debtor paid a down
10 payment of \$20,000 in cash and executed two notes, one for
11 \$1,500,000 (the "First Loan") and one for \$125,000 (the "Second
12 Loan"). The term of the First Loan, as evidenced by The Lawrence
13 Building Company Secured Promissory Note (the "Note"), having an
14 Effective Date of June 1, 2003, is thirty-nine years, broken into
15 what the parties described as the "Initial Term" and the "Second
16 Term."¹

17 The Note calls for interest to accrue at the rate of 4.5%
18 during the Initial Term, with no interest to be paid. Negative
19 amortization applies to the outstanding principal, and interest is
20 compounded annually. The Initial Term runs from the Effective
21 Date (June 1, 2003) until May 31, 2022. The Second Term runs from
22 June 1, 2022 until May 31, 2042, and bears interest under an
23 amortization formula, at a variable prime rate plus 2%, with
24 certain maximum and minimum rates. Payment is to be made monthly
25 until the May 21, 2042 maturity date.

26 Simply stated, the documents provide that no interest

27 ¹ The Note also referred to the Initial Term as the "First
28 Term."

1 reductions are to be made on the First Loan until the expiration
2 of the Initial Term, namely, nineteen years after the Effective
3 Date.

4 The Agreement was accompanied by a Seller Financing Addendum
5 and Disclosure in which a balloon payment of \$3,461,790 is set
6 forth as becoming due on June 1, 2022, the expiration of the
7 Initial Term.²

8 Paragraph 36F.1 of the Agreement further provides that during
9 the first nineteen years of the Agreement, in other words, during
10 the Initial Term of the Note, Debtor is to pay Defendants cash
11 flow based on actual or historical rents at the Property (the
12 "pass-through payments"). Debtor contends that the pass-through
13 payments could not have been additional consideration flowing to
14 Defendants, but rather should be credited against some portion of
15 its obligations under the Agreement and the Note. Defendants
16 dispute that characterization, contending that the Agreement sets
17 forth the understandings of the parties, namely that Defendants,
18 during the Initial Term, were obligated to pay property taxes and
19 insurance on the Property, as consideration for Debtor's payment
20 of the pass-through payments to them. Those mutual obligations
21 cease when the Second Term of the Note commences.

22 In sum, Defendants were to receive a portion of the rents
23 thrown off by the Property; in turn they were to pay the insurance
24 and taxes. During that time the Note would accrue interest on a
25 negative amortization basis, with no payments being made. All of
26

27 ² The court assumes that negative amortization of a
28 \$1,500,000 debt, compounded annually at 4.5%, results in that
amount.

1 that would be reversed at the end of nineteen years, namely Debtor
2 would keep the rents and pay the insurance and taxes, but would be
3 obligated to make monthly payments to Defendants under the Second
4 Term of the Note.

5 Meanwhile, the Second Loan is to be amortized over five
6 years, with the first installment being paid one year after the
7 Effective Date of the Agreement.

8 In 2006 and thereafter, Debtor failed to make payments on the
9 Second Loan and Thush in January, 2007, gave notice of default and
10 began enforcing his rights without recourse to court or the
11 appointment of receiver, as authorized by California Civil Code
12 § 2938.

13 Late in 2007, Debtor sued Defendants in the Santa Clara
14 Superior Court ("Superior Court") setting forth four causes of
15 action and in January, 2008, Debtor filed a voluntary Chapter 11
16 petition in the San Jose Division of this court.

17 Debtor contends that Thush interfered with its rights at the
18 Property, including exercising control by changing locks and by
19 diverting rents from third party tenants to be paid to him rather
20 than to Debtor. This court, through the San Jose Division,
21 ordered the appointment of a receiver and ultimately abstained
22 from further proceedings, permitting the Superior Court to
23 continue to adjudicate the rights of the parties.

24 Debtor's first Chapter 11 was later dismissed and it filed
25 Chapter 11, again in this division, on October 4, 2010.³

26
27 ³ After the San Jose Division's abstention there was a great
28 deal of activity in the Superior Court that is well-known to the
parties and need not be recited here.

1 Defendants sought relief from stay to continue the litigation in
2 Superior Court; Debtor removed the state court action to this
3 court; at the court's request, Debtor commenced this adversary
4 proceeding to set forth more specifically the issues that needed
5 to be resolved.

6 This court acquiesced in the parties' request that it provide
7 a forum for a prompt adjudication of their respective rights,
8 duties and obligations. Accordingly, rather than remand to the
9 Superior Court or grant relief from stay, the court agreed and set
10 the matter for trial.⁴ Defendants sought to eliminate the need
11 for trial by filing the Motion.

12 III. ISSUES

13 In Debtor's complaint commencing this adversary proceeding,
14 it plead four claims for relief: declaratory relief that the pass-
15 through payments had to be applied to some portion of the
16 obligations under the Note; interference with contract, based upon
17 the theory that Defendants, and Thush in particular, interfered
18 with Debtor's relationship with its tenants at the Property;
19 interference with prospective economic advantage; and accounting
20 and determination of set-off.

21 IV. DISCUSSION

22 While Defendants in their Motion addressed the first claim
23 for relief last, the court will reverse that sequence as the
24 dispute over the terms of the Agreement and the Note are critical
25 to a resolution of this case.

26 Basically, Defendants contend that unconventional is not the

27 ⁴ For reasons the court is responsible for that trial date
28 had to be moved from late February to late March.

1 same as ambiguous or unenforceable, and that even though Debtor
2 now contends the Agreement and Note cannot possibly mean what
3 Defendants say they mean, still the Agreement and Note are
4 enforceable and the pass-through payments should not and cannot
5 reduce any principal or interest obligations thereunder. Debtor
6 contends that there is an ambiguity that extrinsic evidence is
7 needed to explain. But even if there were such evidence, Debtor
8 has offered no plausible characterization of how the court would
9 excise Paragraph 36F.1 and still have an agreement that reflects a
10 meeting of the minds of the parties.

11 At oral argument, counsel for Debtor argued that one way to
12 reconcile what she calls the ambiguity would be to apply the pass-
13 through payments to the capitalized interest, i.e., the interest
14 accrued during the Initial Term of the Note. While that is a
15 creative approach, there is no basis in the documentation or the
16 law for the court to do so.

17 A subsidiary issue that the court does not resolve is whether
18 the pass-through payments made since 2003 or even at present were
19 secured obligations of Debtor based upon the Note's incorporation
20 of the Agreement by reference and the fact that the Note is itself
21 secured by the deed of trust that was executed by Debtor when the
22 transaction closed. Because the principal task of the court is to
23 interpret the Agreement to find out whether the pass-through
24 payments should reduce any of the obligations under the Agreement
25 or the Note, and because the court concludes that they do not,
26 whether or not the rents that produced those payments were or are
27 included within the security embraced by the deed of trust, does
28 not need to be decided. The fact is that Defendants, through

1 counsel, have provided the court with a "pay-off" demand if the
2 Property can be sold, and that demand is consistent with the
3 accrual of obligations under the Agreement and the Note without
4 regard to the pass-through payments. If and when the Debtor is
5 able to sell or refinance the Property, the amount that would have
6 to be paid to Defendants has been established in the record.⁵

7 In reaching the conclusion that the Agreement and Note should
8 be construed the way Defendants contend, the court acknowledges
9 that there is some inconsistent terminology in the documents but
10 when taken as a whole, that is the only conclusion one can reach.
11 Accordingly, there is no ambiguity and no need to take extrinsic
12 evidence or to speculate on what the documents might have said.
13 First, while the Purchase Price of the Property is set forth as
14 \$1,645,000, that does not mean there could be no other amounts
15 owing under the Agreement. Indeed, the nineteen years of negative
16 amortization, and thus accrual of interest resulting in a balloon
17 of over twice that amount, in fact increases the total purchase
18 price on a par (other than present value) basis.

19 Second, Paragraph 36F.1 comes under the heading "Other Terms
20 and Conditions" and they are clear in and of themselves. Next,
21 because the Note was subject to negative amortization during the
22 same period of time that the pass-through payments were to be
23 made, the parties could not have contemplated that they would
24 reduce either the principal or the interest due on the Note.

25 From all of the foregoing, the court concludes that there are

26 ⁵ The court also does not need to decide whether any third
27 party buyer of the Property would take subject to the pass-through
28 payment obligations of paragraph 36F.1.

1 no material facts in dispute and further concludes that defendants
2 are entitled to summary judgment on the first claim for relief.
3 They are entitled to a declaration that none of the pass-through
4 payments should be applied to either principal or interest on the
5 Initial Loan or the Second Loan, but represented additional
6 consideration, apart from the simple purchase and sale of the
7 Property. That is the arrangement whereby Defendants were
8 entitled to a certain minimum anticipated amount of cash flow, in
9 turn for which they paid taxes and interest on the Property, while
10 Debtor was entitled to increased rental amounts, which was
11 precisely the way the parties conducted themselves for the first
12 two or three years of their relationship prior to the first
13 default.

14 As to the second claim for relief, the court agrees with the
15 Defendants that it is barred by the statute of limitations for all
16 the reasons set forth in the Motion. As to the third claim, the
17 Superior Court denied Debtor the right to amend a comparable cause
18 of action while the matter was pending there, and under the law of
19 the case, that theory is foreclosed.⁶ As to the fourth claim, the
20 court's review of the Motion satisfies it that Defendants have
21 provided adequate information to Debtor to account for revenues
22 that they received at various times throughout this relationship,
23 and that they have therefore satisfied their accounting

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25 ⁶ The court recognizes that this adversary proceeding is a
26 "separate case" but the parties are the same, the issues are the
27 same, and indeed simply as a matter of convenience the court asked
28 the Debtor to commence a new adversary proceeding rather than to
try to amend yet again the various claims that had been asserted
for years in the Superior Court action that was removed to this
court.

1 obligations. The Defendants do not need to provide an accounting
2 of how they applied the sums collected because the court's
3 decision disposes of that matter. Similarly, to the extent that
4 Debtor believes it is entitled to any set-off, the disposition of
5 the second, third and fourth claims for relief render that issue
6 moot.

7 V. CONCLUSION

8 Defendants are entitled to an order granting the Motion and a
9 judgment in their favor in all respects in this adversary
10 proceeding consistent with this Memorandum Decision. Because it
11 would appear that all that remains is for Defendants to complete
12 their foreclosure of the Property (whether judicially or
13 nonjudicially), relief from stay would appear to be appropriate.
14 If necessary, the court could remand the removed action but a
15 final judgment in this adversary proceeding may suffice. That
16 being said, the court is prepared to give Debtor one short period
17 of time to attempt to effect a sale or refinancing of the Property
18 on terms that would provide Defendants with their pay-off figure,
19 as reflected in the record. In order to ascertain an appropriate
20 length of time for Debtor to do so, and to determine an exact
21 payoff amount, the court will conduct a status conference on March
22 15, 2011, at 9:30 a.m. In the meantime, Defendants should submit
23 the forms of order and judgment disposing of this adversary
24 proceeding and should comply with B.L.R. 9021-1.

25 **END OF MEMORANDUM DECISION**
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